Western Economic Diversification Canada | Diversification de l'économie de l'Ouest Canada

Audit of Third Party Delivery Arrangements

WESTERN ECONOMIC DIVERSIFICATION CANADA

Audit and Evaluation Branch

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Canada

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1.0 Executive Summary

1.1 The Audit of Third Party Delivery Arrangements was identified in Western Economic Diversification Canada's (WD) approved 2009-12 Risk-Based Audit Plan. The area of third party delivery arrangements was one of the key risks identified in the most recent departmental corporate risk profile.

1.2 The objective of the audit was to provide assurance that the risk management framework, governance and controls in place at WD for delivery of programs and projects by third parties were adequate to ensure the achievement of intended results.

1.3 The audit focused on programs and projects where funding was provided to recipients through third party organizations. Operating, investment and loan funds were distributed to third parties by WD, to be used in providing services to clients and to distribute funds through granting loans or funding. The programs and projects selected for this review were: Community Futures Program (CFP), Women's Enterprise Initiatives (WEI), Francophone Economic Development Organization (FEDO), Entrepreneurs with Disabilities Program (EDP), Urban Entrepreneurs with Disabilities Program (UEDP), BC Community Futures – Rural Economic Diversification Initiatives (CF-REDI), Alberta Community Futures-Rural Diversification Initiatives (CF-RDI) and the Primrose Lake Weapons Range Project.

1.4 Most of these individual initiatives have been audited in the past. This audit focused on WD's general processes and controls around managing third party delivery arrangements and did not duplicate prior program-based audit work.

1.5 The audit covered the period from April 1, 2007 to March 31, 2009, and integrated review and analysis of relevant program and policy documents, interviews with key personnel at WD, and testing of transactions. The auditors reviewed a number of key documents including: Treasury Board Policy on Transfer Payments; The Treasury Board Directive on Transfer Payments; and The Report of the Independent Blue Ribbon Panel on Grants and Contributions Programs.

Findings

1.6 Contribution agreements are a critical tool in the management of third party arrangements. Through contribution agreements, WD spells out its requirements that third parties must follow as a condition of funding. In order to achieve the intended results, the terms and conditions of the agreements must be clear and understood by both parties and WD must monitor those terms and conditions on an ongoing basis.

1.7 The regions had been actively monitoring contribution agreements. However, the auditors did find two significant exceptions involving the Women's Enterprise Initiative (WEI) contribution agreements. As a result of the Saskatchewan region not enforcing a clause in the agreement and the Manitoba region enforcing the clause but making a

calculation error, WD had overpaid over $1.6 million to those two recipients. Management had become aware of this situation prior to this audit and had commenced action to resolve this issue and to prevent it from happening in the future.

1.8 The auditors found evidence of project risk assessment processes, active monitoring of third party performance, and financial statement review in all regions. Some opportunities for improvement in these areas were identified in this report.

1.9 Headquarters needs to provide adequate oversight and actively monitor regional practices regarding third party delivery. Headquarters should set out standardized guidelines and procedures for regions to follow when significant issues occur in managing third party relationships. Headquarters should develop these guidelines in consultation with regional program staff.

Statement of Assurance

1.10 In my professional judgement as Chief Audit Executive, sufficient and appropriate audit procedures have been conducted and evidence gathered to support the conclusion that WD has an adequate risk management framework, governance and controls in place for delivery of programs and projects by third parties, subject to the implementation of the recommendations included in this report.

1.11 The assurance is based on a comparison of the conditions, as they existed at the time, against pre-established audit criteria that were agreed upon with management. The assurance is applicable to the policies and processes examined. The evidence was gathered in accordance with Treasury Board policy, directives, and standards on internal audit for the Government of Canada. The evidence has been gathered to be sufficient to provide senior management with the proof of the conclusions derived from the audit.

2. 0 Introduction

Background

2.1 A number of Western Economic Diversification Canada (WD) programs are delivered through arrangements with third parties. One advantage of third party delivery is that third parties have a closer proximity to the clients and are better able to understand client needs. In addition, provision of programs through a third party provides the potential to leverage additional resources and to build upon pre-existing working relationships.

2.2 There are a number of disadvantages to partnering with third parties to deliver programs and projects. By having a third parties delivering programs, WD is distanced from the client and therefore, WD's direct interaction with the client is limited. As well, WD is one step removed from the program delivery and is reliant on the third party to achieve results for which WD is accountable. WD must ensure that adequate controls are in place to limit this risk.

2.3 The audit focused on programs and projects in which third parties received operating, investment, loan, or project funding, and delivered services and funding to clients. The programs and projects reviewed were:

- Community Futures Program (CFP) - support community economic development; diversify the economy; support the creation and expansion of small and medium-sized businesses; maintain and create new employment; and maintain the Minister's capacity to deliver business services to rural communities in Western Canada.

- Women's Enterprise Initiatives (WEI) - assist women entrepreneurs to start or expand their own businesses by promoting the concept to women, increasing availability of capital, and providing services to assist women in developing the experience, expertise, assets and credit histories, enabling them to increase the numbers and strength of women entrepreneurs.

- Francophone Economic Development Organization (FEDO) - develop and provide a full range of services vital to business development such as information, training, mentoring, counseling, entrepreneurship promotion, and the development of special economic development initiatives to francophone entrepreneurs.

- Entrepreneurs with Disabilities Program/Urban Entrepreneurs with Disabilities Program (EDP/UEDP) - provide specialized support, training/coaching, counseling, and small business loans to clients.

- Community Futures – BC Community Futures-Rural Economic Diversification Initiatives (CF- REDI) and Alberta Community Futures-Diversification Initiatives (CF-RDI) - help communities achieve significant rural diversification outcomes by

providing contributions to communities and helping CF organizations strengthen their capacity to identify, develop and deliver projects that diversify the rural economy.

- The Primrose Lake Air Weapons Range Project - assist and promote economic development in the communities within the Primrose Lake Area affected by the establishment of the Primrose Lake Air Weapons Range in 1953 and to enhance the long-term economic viability and sustainability of those communities.

2.4 Most of these individual initiatives have been audited in the past. This audit focused on WD's general processes and controls around managing third party delivery arrangements and did not duplicate prior program-based audit work.

The approved funding and number of organizations funded are summarized in the table below.

Program/Project	Fiscal Year	Funding ($ Million)	# of Org Funded	Notes
Community Futures Program	2007-09	$55.3	94	
Women's Enterprise Initiatives	2007-09	$7.8	4	
Francophone Economic Development Organization	2007-09	$4.3	4	
Entrepreneurs with Disabilities Program/Urban Entrepreneurs with Disabilities Program	2007-09	$3.1	11	
Community Futures – Rural Diversification Initiatives (Alberta)	2007-09	$1.7	1	*Note 1*
Community Futures – Rural Economic Diversification Initiatives (British Columbia)	2008-09	$0.5	1	*Note 2*
The Primrose Lake Air Weapons Range Project	2007-09	$15.0	1	
Total		**$87.70**	**116**	*Note 3*

Note 1 – CF Network of Alberta (CFNA) is the project proponent. CFNA provides funding to CFs in Alberta on a project basis.

Note 2 – Project start date – October 8, 2008. CF Development Association of (CFDA) British Columbia is the project proponent. CFDA of BC provides funding to CFs in British Columbia on a project basis.

Note 3 – Funding excludes loan funds.

Audit Objectives

2.5 The overall objective of the audit was to provide assurance that the governance, risk management framework and controls in place at WD for delivery of programs and projects by third parties were adequate to ensure the achievement of intended results.

The sub-objectives were:

- to determine the effectiveness of the governance framework in place for dealing with third parties;
- to ensure adequate stewardship over funds provided to third parties;
- to ensure a risk management process is in place whereby actions taken are based on assessed risk; and
- to ensure that WD is providing third parties with required resources to discharge their responsibilities.

Key Risks

2.6 The audit program was designed to test the existence and effectiveness of WD's controls to mitigate the following key risks:

- controls at WD are so tight that WD influence third parties to the extent that they become agents of WD;
- third parties mismanage funds provided;
- fraud at third party organization;
- poor accountability from third parties and therefore goals and objectives are not achieved;
- goals and objectives of third parties are not in alignment with WD goals and objectives;
- third parties' performance is not adequately measured in such a way to verify success; and
- inaccurate or unsupported payments to third parties.

Scope and Methodology

2.7 The audit covered the period from April 1, 2007 to March 31, 2009. The audit included review and analysis of relevant program and policy documents, interviews with key personnel at WD, and testing of transactions. The auditors reviewed a number of key documents including: Treasury Board Policy on Transfer Payments; The Treasury Board Directive on Transfer Payments; and The Report of the Independent Blue Ribbon Panel on Grants and Contributions Programs.

Acknowledgements

2.8 The auditors would like to thank WD staff for the timely cooperation and assistance provided to the audit team throughout this engagement.

3.0 Findings and Recommendations

3.1 Oversight and Performance Measurement

Criteria: Effective oversight exists to ensure timely, accurate, and sufficient financial and operating information and reporting. Adequate monitoring is done to ensure compliance to terms and conditions of contribution agreements. Third parties have a clear understanding of priorities and performance targets. Appropriate performance measures linked to planned results were identified. Targets were established. Reports are periodically verified for accuracy and results are compared to expectations. Processes and procedures exist to support the reliability of data used for performance measurement. WD has clearly defined and communicated strategic directions, authority and responsibilities to third parties.

3.1.1 The auditors found that WD had an effective governance and oversight framework, and that controls were in place from program inception to project completion. WD had all the relevant Treasury Board program authorities in place. Adequate project development, assessment and approval processes were in place.

3.1.2 Contribution agreements are a critical tool in the management of third party arrangements. Through contribution agreements, WD spells out its requirements that third parties must follow as a condition of funding. In order to achieve the intended results, the terms and conditions of the agreements must be clear and understood by both parties and WD must monitor those terms and conditions on an ongoing basis.

3.1.3 Contribution agreements examined were found to be consistent with existing program authorities. The agreements set out the purpose of the project, project costs, funding, eligible and ineligible expenditures, deliverables, reporting performance targets and indicators, along with obligations and responsibilities of both parties.

3.1.4 During the audit, the auditors came across two significant errors related to the Women's Enterprise Initiatives (WEI) loan funds that had occurred in the Saskatchewan and Manitoba regions. The WEI agreements included a clause defining the parameters when interest earned on WEI loan funds must be used to offset operating costs and reduce the amount of WD's contribution.

3.1.5 In Saskatchewan's case, the Project Officer assigned to the WEI monitored the contribution agreement but did not apply the relevant clause. As at March 31, 2009, the total accumulated interest not transferred to the Operating Fund was $1,118,892. Regional management first became aware of this omission in the fall of 2008 and then started action to resolve the issue in conjunction with headquarters. During the entire period in which WD did not apply this clause correctly, the WEI's external auditors provided WD with annual assurance that the WEI was complying with the contribution agreement in all material aspects.

3.1.6 In Manitoba, the region had enforced this same clause since the agreement started, but the region made an error in calculating the amount to be transferred. The region realized that they had incorrectly calculated the amount in April 2009, following a conference call with headquarters to discuss the Saskatchewan omission. As at March 31, 2009, the total

accumulated interest that should have been transferred to the Operating Fund was $525,796. The cumulated overpayment by WD for both regions was over $1.6 million.

3.1.7 Both Saskatchewan and Manitoba regions are strengthening their monitoring controls to ensure this situation does not recur. In addition, headquarters needs to establish guidelines and procedures for regions to follow both to prevent future recurrences and on how to deal with future significant issues if they arise.

3.1.8 One of WD's controls to ensure that third parties' (CF's, WEI's and FEDO's) activities align with WD's objectives and priorities is the requirement for third parties to develop annual operating plans and to submit them to WD for review. WD has developed operating plan templates to be used by third parties to assist their development of their annual operating plans. In Saskatchewan, the Program Manager did not sign off on 7 out of 12 operating plans sampled. The region will establish procedures to ensure that all future operating plan reviews are signed off.

3.1.9 A key control for WD to be able to accurately determine the performance of third parties is the establishment of performance measures and standards. Starting in 2008-09, WD established minimum performance standards for CFs, WEIs and FEDOs based on agreed upon performance indicators. Project Officers monitored these minimum performance standards in addition to other agreed upon performance targets of the recipients. Alberta was the only region that formally advised the individual CFs and WEI of their performance in 2008-09 against the standards.

3.1.10 To provide effective oversight, regional management needs to be advised of those third parties that did not meet the minimum performance standards. Alberta has initiated a formal management reporting process that includes a mid year performance report to the Director General and a report on performance of partners to the Assistant Deputy Minister. The other regions have various procedures in place around the tracking and reporting of performance standards.

3.1.11 The auditors found inconsistency across the regions in the completion of the Quality Assurance Reporting File Contents and Best Practices Checklist (QAR). Officers need to complete and sign off a QAR annually for each project to ensure responsible fund management and adequate reporting on performance.

3.1.12 The auditors did not find any recent management assessment as to whether delivering programs through third parties achieved program results in a more efficient and cost-effective manner than through direct program delivery.

Recommendation # 1: WD should strengthen regional practices for monitoring compliance to contribution agreements. In addition, WD headquarters should engage in risk-based active monitoring of regional practices.

Recommendation # 2: To enhance regional oversight, regions should establish a formal performance reporting process on the success of programs and projects delivered by third parties and on any significant issues identified. This process should include an annual report to regional senior management.

3.2 Stewardship and Accountability

Criteria: Payments made by WD to third parties are accurate, adequately supported and approved. Financial statements/reports are examined and analyzed to ensure funds were used for intended purposes. WD takes appropriate action to recover ineligible expenditures to third parties.

3.2.1 The claims review process is a critical control to ensure that WD only pays for eligible expenditures made by third parties. Unlike the other three regions, Saskatchewan does not have a separate and distinct Monitoring and Payments group. Project Officers manage projects from start to finish. Project development, assessment and administration functions were not segregated from the claim processing and financial statement review functions in Saskatchewan. Program managers did review and approve claims, so some supervisory controls partially compensate for the lack of segregation of duties. In the other three regions, where Monitoring and Payments Officers exist, adequate documentation, review, and sign off on claims was noted.

3.2.2 One of the key tools that WD used to assess third party compliance and performance was the review of financial statements. Although all regions performed review on the financial statements submitted by the recipients, review processes were not consistent across the regions. Alberta and Manitoba have developed financial statement review templates. BC has developed a review checklist. As a result of this audit, the BC region will initiate discussions with the other regions regarding the development and use of a common checklist and template.

Recommendation # 3: WD should standardize the financial statement review processes and should develop standard financial statement and loan fund review templates.

3.3 Risk Management

Criteria: Management has a documented approach with respect to risk management. Appropriate action is taken where the risk assessment indicates it is warranted.

3.3.1 WD was found to have a risk management framework and measures in place to manage and mitigate risks associated with third party delivery programs and projects. The framework includes:

- monitoring recipients compliance to agreements;
- reviewing project proposals, operating plans or work plans to ensure recipients set out their goals and objectives, planned activities, budgets, and performance targets;

- reviewing financial statements/reports to ensure recipients provide proper accountability of funds received and funds are used for intended purposes;
- reviewing quarterly performance and/or progress reports to monitor recipients' performance in delivering WD programs/projects;
- conducting annual project risk assessment and monitoring activities based on risks;
- conducting risk review of projects during claim processing;
- reviewing claims to ensure they are accurate, supported and authorized; and
- providing training and guidance, program information, performance reporting guidelines, and claim packages to recipients.

3.3.2 The regions conducted annual project risk assessments for recipients receiving core funding (e.g., CFs, WEIs, FEDOs). Monitoring activities are based on the risk assessed and include site visits, meetings with the recipient staff, or attendance at a board meetings where required. Officers were found to be actively involved in the annual project risk assessment process. Officers did not complete risk assessments in exceptional cases (e.g., living centres or credit unions), but WD is moving to doing risk assessments for all projects.

3.3.3 WD has been delivering programs for years through third parties and has very experienced staff in each region. WD relies on the professional judgment of staff to assess risk and intervene accordingly commensurate with the level of risk. WD should develop risk-based intervention guidelines to assist regional program officers with some guidance when some intervention steps are necessary to deal with issues emerging from third parties. These guidelines should have specific provisions to deal with suspected or alleged cases of fraud at third party organizations where WD funding is possibly impacted.

Recommendation # 4: WD should develop risk-based intervention guidelines and procedures to assist regional program officers in their dealings with third parties.

3.4 Training and Support

Criteria: WD ensures that third parties have the necessary training, tools, resources and information to support the discharge of their responsibilities.

3.4.1 The auditors found that WD has invested in training for third parties. In 2008, 102 business network partners (90 CFs, 4 CF Associations, 4 WEIs and 4 FEDOs) received $10,000 each for computer upgrades. The regions indicated that training on quarterly performance reporting had been provided to users (CFs, WEIs, and FEDOs) of The Exceptional Assistant software. In addition, regions provided recipients with the WD Financial Statement Guide, operating plan guidelines and templates, performance reporting guidelines and claim packages. The regions provided assistance to recipients in preparing operating plans and performance reports.

4.0 Conclusion

4.1 For the most part, WD has the risk management framework, governance and controls in place for delivery of programs and projects by third party arrangements. This report identified some areas of suggested improvement to strengthen the controls and reduce WD's overall residual risk from third party delivery arrangements.

4.2 The audit examined several audit criteria used to assess the identified key risks, management control framework and practices. The following is the summary of results.

Results Summary by Audit Criteria

Assessed Audit Criteria	Results
Oversight and Performance Measurement	Criteria mostly met
Stewardship and Accountability	Criteria mostly met
Risk Management	Criteria mostly met
Training and Support	Criteria met

5.0 Audit Strategies and Approach

Planning

5.1 Audit planning started in May 2009 and fieldwork was completed in August 2009 in all four regions at WD. Pre-engagement meetings and preliminary survey were completed to facilitate identification of key risks, audit criteria, control elements and audit strategies. WD staff were involved as necessary throughout the audit process.

Standards and Methodology

5.2 Government of Canada internal auditing standards were used throughout the planning, conducting and reporting phases of the audit. The audit was evidence-based in order to ensure the audit assurance is fully supported. All available evidence has been examined and analyzed against the audit criteria in order to recap the results. Sources of evidence included: interviews, review and analysis of policies, background literature and management practices at WD, review of previous audits or reviews by other assurance providers, regional visits, analytical reviews, and elaboration on cause and effect of conditions, and follow-up on previous internal audits.

5.3 Many of the individual initiatives covered under third party arrangements have been audited in the past. This audit focused on WD's general processes and controls around managing third party delivery arrangements and did not duplicate prior program-based audit work.

Sampling

5.4 The identified key risks were considered in selecting project files for examination. As part of the audit evidence, the auditors judgementally selected 22 representative project files from all regions for examination and tested the samples against the audit criteria.

Audit Team

WD internal audit staff conducted this audit.

Donald MacDonald	Chief Audit Executive
Kathy Locke	Project Leader
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